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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1946

NO. _____

ENSLEY BANK AND TRUST COMPANY,
Petitioner

vs.

UNITED STATES OF AMERICA,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

May it please the Court:

The petitioner respectfully prays for a writ of certioriari to the United States Circuit Court of Appeals for the Fifth Circuit at New Orleans, Louisiana, to hear this cause and to review the decision of the Circuit Court of Appeals in affirming the judgment of the United States District Court for the Northern District of Alabama, Southern Division. Petitioner respectfully shows to this Honorable Court:

1

SUMMARY STATEMENT OF THE MATTER INVOLVED

There is no dispute as to the facts. Your petitioner was activated in June, 1932 to avert the imminent failure of the Ensley National Bank (hereinafter referred to as "National Bank"). Pursuant to a contract (R. 13) the petitioner assumed National Bank's liabilities in the amount of $355,080.63, (R. 16) and undertook to act as its liquidating agent. (R. 15). National Bank agreed to repay to petitioner $355,080.63, the amount of the liabilities so assumed (R. 17-18; 97-98) and, in addition, to pay the petitioner an amount equivalent to eight per cent (8%) interest on the average daily balance due petitioner on that obligation to repay (R. 18). National Bank pledged its assets to secure its liability to petitioner under the contract (R. 20-21), and it was stipulated that collections on the pledged assets might be applied by petitioner at its election either to repayment of the principal debt due from National Bank, or to payment of the eight per cent (8%) charge. (R. 19).

The petitioner collected substantial sums on sales of the pledged assets. During practically all of 1933, and during the material portion of 1934, the sums so collected were applied by petitioner, first, to payment of its claim to the eight per cent charge, and the balance was applied to payment of the principal debt due from National Bank. (R. 57-61; 102-103).

In the returns filed on the cash receipts and disbursements basis by petitioner for the calendar years 1933 and 1934, the amounts so collected were included in its gross income. (R. 54-55). Petitioner, on said returns, claimed a deduction from its gross income for 1933 in the amount

of $13,039.03, and for 1934 in the amount of $14,318.03, each deduction being claimed on account of a charge-off as worthless of that part of the principal debt due it from National Bank. The Commissioner disallowed the claimed deductions, and assessed additional taxes for each year as a consequence of such disallowance. (R. 55-56).

Petitioner filed claims for refund within the time prescribed by law and, upon the Commissioner's rejection thereof, paid the asserted deficiencies. Petitioner instituted its action in the District Court within two years of the date on which the Commissioner notified petitioner of the rejection of said claims for refund. (R. 102).

In its pleadings in the District Court, and in the briefs filed and arguments made by its Counsel in both the District Court and the Circuit Court of Appeals, the United States defended against petitioner's claim on three grounds. It was urged, first, that the 1932 transaction was not a lending operation but was rather a purchase by petitioner of National Bank's business; second that, even if the 1932 transaction was in some sense a credit operation, yet the claimed deductions for ascertained worthlessness were not available to petitioner since petitioner's liability was asserted to have been that of a guarantor; and, third, the United States argued that, in any event, the claimed deductions were not available to petitioner since National Bank's obligation to repay did not mature until June 19, 1934. The United States did not assert that the petitioner failed to ascertain National Bank's obligation to have been worthless in part. On the contrary, in the answer filed by the United States in the District Court, it is specifically avered that such an ascertainment was made in 1932.

In paragraph 6 (c) of its Complaint filed in the District Court, petitioner alleged as follows:

"From detailed examinations made of its assets by officers of The First National Bank of Birmingham, and by agents of various state and federal banking authorities, the plaintiff had before the end of 1933 determined that the maximum recovery to be expected from the assets pledged to it plus the maximum recovery to be expected from the stockholders of the Ensley National Bank was less than the amount of the debt owed to it by the Ensley National Bank by an amount substantially greater than $13,039.03. The plaintiff, therefore, as of December 30, 1933, charged off on its books $13,039.03 of the debt . . . as worthless and deducted that sum from its gross income as reported. . . ." (R. 5-6).

In paragraph 7 (c) of its said Complaint, a similar allegation was made by petitioner with respect to the amount of $14,318.03 claimed as a deduction in the return filed for the calendar year 1934. (R. 9-10).

The United States, in paragraph VI of the answer filed by it in the District Court, alleged as follows:

". . . As to the allegations in subdivision (c) of paragraph 6 of the bill of complaint, does not deny such allegations except the allegation that plaintiff had before the end of 1933 determined the maximum recovery to be expected from the assets of the said Ensley National Bank pledged to it, but on the contrary specifically avers that any loss plaintiff expected to sustain from the liquidation of said assets was ascertained prior to the year 1933, and, therefore, specifically avers that plaintiff was not entitled under such facts and the law to a deduction of $13,039.03 from gross income as a debt ascertained to be worthless and charged off in the said year 1933. . . ." (R. 46).

In paragraph VII of the said answer, the United States alleged as follows:

". . . does not deny the allegations in subdivisions (a), (b), (c), (d), (e) and (f) of paragraph 7."

In its "Objections by Defendant to Plaintiff's Proposed Conclusions of Law," the United States asserted as follows. (R. 91):

> "The evidence fairly shows that the good will was acquired by plaintiff to make up the difference between the amounts of indebtedness assumed and the amounts expected to be realized out of the liquidation."

There were only these issues presented by the pleadings and the conduct of the trial in the courts below: Did the 1932 transaction give rise to a debtor-creditor relationship, or did it result merely in the acquisition of a capital asset by the petitioner? If the 1932 transaction did give rise to a debtor-creditor relation between petitioner and National Bank, was petitioner's deduction for ascertained worthlessness unavailable because petitioner was a "guarantor," or because National Bank's liability did not mature until July 19, 1934? At no time in the proceedings before either court did counsel for the United States take the position that, even if the 1932 transaction was a lending operation, petitioner nevertheless was not entitled to the deductions claimed in 1933 and 1934 because of a failure to ascertain partial worthlessness in those years. Petitioner demonstrated its positive ascertainment of partial worthlessness in 1933 and 1934 by showing that since some loss on the principal debt was ascertained in 1932, when both possible collections on pledged assets *and* National Bank stockholders' liability were considered, then necessarily an *additional* loss on the principal debt was incurred in 1933 and 1934 when collections made on the pledged assets were applied to payment of petitioners' claim for interest.

The District Court rendered a judgment for petitioner on issues from which the United States took no appeal, and it rendered a judgment against petitioner on the issue as

to good will made by the pleadings, viz, whether or not the 1932 transaction was a lending operation such as is contemplated by the provisions of the Revenue Acts of 1932 and 1934 which authorize the deduction of that portion of a debt ascertained to be worthless and charged-off in the year claimed. The District Court held that your petitioner purchased National Bank's "good will," which was a capital asset such as could give rise to a deduction only upon a subsequent sale for an amount less than petitioner's basis on such asset. The District Court's ninth conclusion of law (R. 109) is as follows:

> "The good will and the business of Ensley National Bank as acquired by plaintiff under the contract was a capital asset. Plaintiff paid for said capital asset the difference between the amount of liabilities assumed and paid under the contract and the amounts realized and collected on liquidation."

The Circuit Court of Appeals' opinion (R. 174) held that the 1932 transaction was such a lending operation as in a proper case might give rise to the deductions claimed for ascertained partial worthlessness. But that court's opinion proceeded to affirm the judgment below on a ground expressly excluded by the pleadings, namely that petitioner failed to ascertain the amount collectible from National Bank's stockholders, and so failed in 1933 and 1934 to ascertain the latter's debt to have been partially worthless. In the course of that opinion, the court said:

> "We do not think the State bank [petitioner] invested $355,000 in this good will, or any measurable sum whatever. It is true that it was a capital asset, and that any gain or loss on it was not realized until it was disposed of in 1935. But we hold that its acquisition under the circumstances does not prevent the note from being a debt. (R. 177-178).

"* * * Appellant [petitioner] argues that it was practically certain in [1933 and 1934] that the note [of National Bank] could not be paid out of the transferred assets, and the witnesses so say; and that when appellant [petitioner] took money from the proceeds of the liquidation each year for its own compensation or interest (creating taxable income for itself) the secured debt was rendered certainly by that much less collectible; and the charge-offs are in each year less than the compensation. The argument would have force, except that the debt was also secured by the stockholders' liabilities of $200,000.00. . . The evidence does not show that it was clearly apparent either in 1933 or 1934 that the transferred assets plus the stockholders' liabilities would not eventually pay the note. A case is not made that the Commissioner arbitrarily refused a partial bad debt deduction to which in the tax years in question the taxpayer was entitled." (R. 178-179).

Petitioner filed its petition for rehearing in due course, on April 18, 1946 (R. 181). In that petition it pointed out that the United States, in its pleadings filed in the District Court, specifically averred that the loss had been ascertained in 1932. (R. 181-183). But the Circuit Court of Appeals, on May 15, 1946, denied the petition for rehearing without opinion. (R. 184).

STATEMENT DISCLOSING BASIS UPON WHICH IT IS CONTENDED THIS COURT HAS JURISDICTION.

Jurisdiction of this cause is conferred upon this Honorable Court by Judicial Code, Section 240, as amended; United States Code, Title 28, Section 347.

The judgment of the Circuit Court of Appeals was entered April 10, 1946 (R. 180), and petitioner's motion for rehearing was denied on May 15, 1946. (R. 184).

3
QUESTIONS PRESENTED

(1) As the United States in its pleadings alleged that petitioner in 1932 ascertained that its total recovery from National Bank and its stockholders would be less than the principal debt due from National Bank, did the Circuit Court of Appeals properly base its affirmance on petitioner's failure to prove the probable amount which could be recovered by it from National Bank and its stockholders? Petitioner contends that this issue, having been excluded by the pleadings, was not available for consideration by the Circuit Court of Appeals.

(2) Did the Circuit Court of Appeals, in affirming the judgment of the District Court upon an issue of fact excluded by the pleadings, err in failing to remand the case to the District Court to allow petitioner the opportunity to establish before that court by other evidence additional facts to rebut this new and unexpected issue? Petitioner contends that even if the issue as to ascertainment could properly be considered, the Circuit Court of Appeals should at the very least have remanded the case to the District Court to take additional evidence thereon, since in the present state of the case, the petitioner has never been allowed the opportunity to present evidence on the issue raised for the first time by the opinion of the Circuit Court of Appeals.

4
REASON RELIED ON FOR THE ALLOWANCE OF THE WRIT

The reason relied on for the allowance of the writ is that the Circuit Court of Appeals so far departed from the accepted and usual course of judicial proceedings as to call

for an exercise of the power of supervision of this Honorable Court.

(1) The Circuit Court of Appeals based its affirmance of the judgment of the District Court upon a statement as of fact—i.e. the petitioner's failure in 1933 and 1934 to ascertain the recovery to be had from National Bank's stockholders. Since the answer filed by respondent in the District Court "specifically avers" that petitioner made such an ascertainment as early as 1932, the petitioner properly refrained from introducing evidence to establish the fact before the District Court, and the Circuit Court of Appeals could not properly base its opinion on an assertion that the facts were not as alleged by both parties in their pleadings before the District Court. *Helvering v. Wood,* (1940), 309 U.S. 344; *General Utilities and Operating Co. v. Helvering,* (1935), 296 U.S. 200; *Helvering v. Salvage,* (1936), 297 U.S. 106; *cf. Minnich v. Gardner,* (1934), 292 U.S. 48. See *LeTulle v. Scofield,* (1940), 308 U.S. 415, at p. 416. See also, *Rules of Civil Procedure for the District Courts of the United States,* Rule 8 (d).

(2) Even if the Circuit Court of Appeals had authority to consider the ground upon which it affirmed the judgment of the District Court, then, since its action was based on a question of fact which was not raised in the District Court and upon which the petitioner therefore has never had an opportunity to present evidence, the Circuit Court of Appeals erred in affirming the judgment below in that, under such circumstances, the petitioner would be entitled to a new trial and such an opportunity. *Helvering v. Richter,* (1941), 312 U.S. 561; *Hormel v. Helvering,* (1941), 312 U.S. 552; *Helvering v. Gowran,* (1938), 302 U.S. 238.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari may issue out of and under the seal of this Honorable Court directed to the United States Circuit

Court of Appeals for the Fifth Circuit commanding said court to certify and send to this court on a day certain, to be therein designated, a full and complete transcript of the record of all of the proceedings in the Circuit Court of Appeals in said cause styled *"Ensley Bank and Trust Company, appellant, v. United States of America, appellee,"* No. 11,465 on its docket, to the end that said cause may be reviewed and determined by this court as provided by Section 240 of the Judicial Code, as amended.

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Birmingham, Alabama
Attorney for Petitioner

LEE C. BRADLEY, JR.
WHITE, BRADLEY, ARANT & ALL
Of Counsel

NO._____

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1946

ENSLEY BANK & TRUST COMPANY, *Petitioner,*

vs.

UNITED STATES OF AMERICA, *Respondent.*

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I
THE OPINIONS OF THE COURTS BELOW

The District Court's findings of fact and conclusions of law are printed at pages 92 through 110 of the Record. The District Court did not write an opinion. The opinion of the Circuit Court of Appeals is printed at page 174 of the Record, and is reported in 154 F. (2d) 968.

II
SPECIFICATION OF ERRORS

1. Since respondent did not raise by its pleadings, evidence, argument or otherwise the defense upon which the Circuit Court of Appeals affirmed the judgment of the District Court, the Circuit Court of Appeals erred in considering such defense and in basing its judgment thereon.

2. The Circuit Court of Appeals erred in affirming the judgment of the District Court without affording petitioner the opportunity to establish before the District Court by new evidence additional facts to disprove the new theory upon which the Circuit Court of Appeals based its judgment.

III

Applicable provisions of the statute and of the regulations are set out in Appendix A.

IV

ARGUMENT

POINT A

The Circuit Court of Appeals based its affirmance of the judgment of the District Court upon a statement as of fact—i.e. the petitioner's failure in 1933 and 1934 to ascertain the recovery to be had from National Bank's stockholders. Since the answer filed by respondent in the District Court "specifically avers" that petitioner made such an ascertainment as early as 1932, the petitioner properly refrained from introducing evidence to establish the fact before the District Court, and the Circuit Court of Appeals could not properly base its opinion on an assertion that the facts were not as alleged by both parties in their pleadings before the District Court.

The United States' pleading in the District Court asserted that petitioner *in 1932* ascertained a loss on National Bank's debt when both the pledged assets and the National Bank stockholders' liability were considered. (R. 5-6; 46). As will hereinafter appear, the petitioner in both courts below based its case on the proposition that, since there were only those two sources from which it might have received payment of National Bank's principal debt and of the interest thereon, it necessarily ascertained an *additional*

loss in 1933 and 1934 when it applied collections on the pledged assets to payment of its claim for interest. For, in so doing, petitioner necessarily reduced still further the already inadequate funds available for payment of National Bank's principal debt.

As has been demonstrated above, counsel for the United States did not at any time raise the issue of ascertainment. Counsel for the United States urged that there was no debt, but rather a purchase of a capital asset. In making that argument, counsel for the United States necessaily took the position that petitioner ascertained in 1932 that its recovery from all sources would be less than the amount of National Bank's debt. For otherwise there would have been no room for the contention that petitioner purchased a capital asset at a cost equal to the difference between such anticipated recovery and the amount of that debt. In other words, counsel for the United States based their entire case in both courts below upon the premise that petitioner ascertained a loss in the transaction in 1932, and purchased National Bank's good will for the amount of that loss. The District Court rendered its judgment on that theory.

In the alternative, counsel for the United States argued that, even if there had been a debt, nevertheless no deduction for partial worthlessness was available since petitioner was alleged to have been a "guarantor," and since the obligation of National Bank was alleged not to have matured at the time the deductions were claimed.

On this state of the record, the Circuit Court of Appeals decided the "Capital Asset" issue in petitioner's favor but held against petitioner on the ground that there had been no ascertainment of partial worthlessness during the years for which the deduction was claimed.

Your petitioner prays for the writ on the ground that the issue as to ascertainment was not properly raised in this

case, and, therefore, that such issue was not available for consideration by the Circuit Court of Appeals.

In *General Utilities and Operating Company v. Helvering,* (1935), 296 U.S. 200, the corporation had declared a dividend of stock in another company. The corporation's stockholders later sold at a profit the stock received by them as such dividend. The issue was whether or not the corporation was taxable on the profit received on that sale of the stock. Before the Board of Tax Appeals, the Commissioner urged only that the corporation actually declared a cash dividend payable in stock. In the Circuit Court of Appeals the Commissioner raised the additional argument that the stockholders, in effecting the sale, were in reality acting as agents of the corporation. This court held the second ground not available either to the Commissioner or to the Circuit Court of Appeals, saying:

> "The second ground of objection, although sustained by the court, was not presented to or ruled upon by the Board. The petition for review relied wholly upon the first point; and, in the circumstances, we think the court should have considered no other. Always a taxpayer is entitled to know with fair certainty the basis of the claim against him. Stipulations concerning facts and any other evidence properly are accommodated to issues adequately raised."

This court has reaffirmed the principle that new issues may not be raised by the United States for the first time on appeal in two later decisions. *Helvering v. Salvage,* (1936), 297 U.S. 106; *Helvering v. Wood,* (1940), 309 U. S. 344.

This petition raises an even more obvious case for the application of that principle. For here, counsel for the United States have *never* argued the issue as to ascertainment. That issue was raised by the Circuit Court of Ap-

peals on its own motion, without the benefit of evidence on the point, and without any argument by counsel for either side.

The Circuit Court of Appeals, in basing its decision on an issue not presented to it for consideration, departed from the accepted course of judicial proceedings. This Honorable Court should issue its writ, as prayed herein, in an exercise of its power of supervision.

POINT B

Even if the Circuit Court of Appeals had authority to consider the ground upon which it affirmed the judgment of the District Court, then, since its action was based on a question of fact which was not raised in the District Court and upon which the petitioner therefore has never had an opportunity to present evidence, the Circuit Court of Appeals erred in affirming the judgment below in that, under such circumstances, the petitioner would be entitled to a new trial and such an opportunity.

This court has indicated that, in some circumstances, the United States will not be precluded from raising a new issue in an appellate court, but that, if such a new issue is raised, the case should be remanded to give the taxpayer an opportunity to present additional evidence upon the new issue.

This petitioner filed in the Circuit Court of Appeals a petition for rehearing in which, among other things, it was urged that the case should be remanded to the District Court to permit it to introduce new evidence showing that the loss was ascertained when *both* collections on the pledged assets and from the National Bank stockholders were considered.

In *Hormel v. Helvering,* (1941), 312 U.S. 552, and in *Helvering v. Richter,* (1941), 312 U.S. 561, where short term trusts were involved, this court held that the case should be remanded for additional evidence where the United States raised for the first time on appeal an issue as to taxability of the income to the grantor under Section 22 (a) of the Internal Revenue Code. In *Hormel v. Helvering, supra,* the court said:

> "Ordinarily an appellate court does not give consideration to issues not raised below. For our procedural scheme contemplates that parties shall come to issue in the trial forum vested with authority to determine questions of fact. This is essential in order that parties may have the opportunity to offer all the evidence they believe relevant to the issues which the trial tribunal is alone competent to decide; it is equally essential in order that litigants may not be surprised on appeal by final decision there of issues upon which they have had no opportunity to introduce evidence. And the basic reasons which support this general principle applicable to trial courts make it equally desirable that parties should have an opportunity to offer evidence on the general issues involved in the less formal proceedings before administrative agencies entrusted with the responsibility of fact finding. Recognition of this general principle has caused this Court to say on a number of occasions that the reviewing court should pass by, without decision, questions which were not urged before the Board of Tax Appeals. . . ."

Your petitioner argues that since the issue as to ascertainment was not raised or considered in the District Court, it was not available either to the United States on appeal, or to the Circuit Court of Appeals. There is no circumstance justifying the failure to raise the issue in the District Court such as was present in *Helvering v. Hormel, supra.* But even if such circumstances do exist in this case,

at the very least the Circuit Court of Appeals should have remanded the case to the District Court so as to afford your petitioner an opportunity to present evidence on the new and unexpected issue.

CONCLUSION

It is respectfully submitted that this case is such as to call for the exercise by this Honorable Court of its supervisory powers, and we, therefore, respectfully pray that the petition for writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit be granted.

Respectfully submitted,

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Of Counsel

APPENDIX "A"

The applicable statutes are the Revenue Act of 1932, c. 209, 47 Stat. 169, and the Revenue Act of 1934, c. 277, 48 Stat. 680. The deductions claimed are allowed by Section 23 (j) of the 1932 Act and by Section 23 (k) of the 1934 Act, which control the years 1933 and 1934 respectively. The sections in the two acts are identical and read as follows:

> Sec. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income, there shall be allowed as deductions:
>
> "(j) or (k) BAD DEBTS. Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction."

The relevant portions of Treasury Regulations 77, promulgated under the Revenue Act of 1932, and of Treasury Regulations 86, promulgated under the Revenue Act of 1934, are identical. Article 191 of Regulations 77 provides in part as follows:

> "Art. 191. BAD DEBTS. * * * Where all the surrounding and attending circumstances indicate that a debt is worthless, either wholly or in part, the amount which is worthless and charged off or written down to a nominal amount on the books of the taxpayer shall be allowed as a deduction in computing net income. * * * Before a taxpayer may charge off and deduct a debt in part, he must ascertain and be able to demonstrate, with a reasonable degree of certainty, the amount thereof which is uncollectable. * * * In determining whether a

debt is worthless in whole or in part the Commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor. Partial deductions will be allowed with respect to specific debts only.

"Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. * * *"

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

NO. 387

ENSLEY BANK AND TRUST COMPANY,
Petitioner

vs.

UNITED STATES OF AMERICA,
Respondent

REPLY BRIEF FOR PETITIONER

I

The brief filed for the United States does not deny petitioner's statement that "counsel for the United States did not at any time (in the courts below) raise the issue of ascertainment" (Brief for Petitioner, p. 13), except by an ambiguous quotation from the Government's brief in the Circuit Court of Appeals. (Brief for the United States, p. 12). That quotation as made is incomplete. The entire statement made in the Government's brief in the Circuit Court of Appeals follows:

> "Here there was no abuse in the Commissioner's discretion because there was no showing that the debt was recoverable only in part. The evidence below does not establish that the debts were in fact uncollectible. Here taxpayer acquired by an outright sale and transfer a valuable line of deposits, the name of National and the good will of the latter and became the sole and dominant factor in the banking business in the Ensley District. (R. 97). *The trial court held that under the*

contract taxpayer paid National for this good will, the difference between the reasonable value of the assets pledged by National and the amount of indebtedness assumed by taxpayer. The good will was clearly considered by all parties as an item of value. National had an established business at the time. When times were good its deposits ran as high as $1,250,000. (R. 97). There was undoubtedly value to its name and bank location as well as its depositors' lists. First National Bank of Birmingham took over taxpayer's deposit liabilities in consideration of the good will and paid cash in addition thereto. (R. 98). The value or lack of value of this good will is not shown by the testimony of Holcomb, manager of one of taxpayer's branch banks that the deposits could not be sold in 1932. (R. 126). Good will is an element of value which inheres in the fixed and favorable consideration of customers arising from an established and well known and conducted business. While Mr. Holcomb was familiar with the affairs of the bank he did not pose as an expert on good will valuation. There is no evidence that he ever appraised good will as an expert or ever took into consideration all elements required in making an appraisal of such items. Here the good will had a value that could only be measured over the years by taking into consideration the history of the business and weighing the good years along with the bad.

"The trial court held that the value of the good will was not shown and was immaterial, the material question being what taxpayer agreed to pay for the same. The taxpayer paid for this good will the difference between the amount of liabilities assumed and the amounts realized and collected on liquidation. (R. 106, 109)."*

*Emphasis added. Citations omitted.

II

The brief filed for the United States refers to the denial made in the amendment to defendant's answer as filed in the District Court. But that denial is of the taxpayer's assertion that taxpayer did not ascertain a loss *prior to or at*

the time of its assumption of the liabilities of National Bank. (R. p. 3). When that denial is read in the light of the Government's specific averment that a loss *had* been ascertained prior to the year 1933, it becomes obvious now, as it was obvious during the trial in the District Court, that the only issue litigated was the issue as to good will. In other words, the complaint filed by petitioner in the District Court alleges both (a) that there was *no* ascertainment of loss as of August 19, 1932; and (b) that there *was* an ascertainment during 1933. The Government's answer as amended, denies that there was no ascertainment as of August 19, 1932, and specifically avers that there had been an ascertainment of loss prior to 1933. In order to sustain its position as to good will, it was necessary for the Government to assert that a loss was ascertained by petitioner on August 19, 1932, the date of the take-over.

III

The brief filed for the United States refers to the examination of witnesses by counsel for taxpayer in the District Court as establishing that ascertainment was an issue in that court. (Brief for United States, pp. 15-16). But, taken in their context, the questions refered to demonstrate that both counsel were directing their examination exclusively to the good will issue. The cross-examination of the witnesses by counsel for respondent in the District Court, to which the respondent so refers, all was directed, not to the years 1933 and 1934, but to the situation on August 18, 1932. That cross-examination shows that the petitioner's evidence as to ascertainment (referred to in respondent's brief at pages 15-16), was accepted by counsel for respondent, who undertook to demonstrate that the petitioner ascertained a loss not only in later years, but also as early as 1932. The question whether the 1932 transaction created a debtor-creditor relation between petitioner and Na-

tional Bank, or resulted in the acquisition of a capital asset is the only question with respect to which that line of cross-examination was relevant, and is the only question upon which it was offered. The taxpayer relied on the Government's specific assertion that a loss was ascertained prior to the year 1933, and based its entire case on a mathematically demonstrable increase in that loss during the years 1933 and 1934. Such reliance was not merely justifiable; there was no other issue available to either party in view of the pleadings.

IV

The brief for the United States points to no pleading of respondent, and to no argument made in brief or orally by counsel for respondent, respecting an issue as to ascertainment. The only issue raised, and the only issue considered by the District Court or by counsel was the issue as to good will. The Circuit Court of Appeals obviously departed from the accepted and usual course of judicial proceedings in considering any other issue. The case demands a further review in this Court.

Respectfully submitted,

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Of Counsel

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CITATIONS

712632—46——1

In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 387

ENSLEY BANK & TRUST COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The District Court expressed its views in a letter to counsel, which is not contained in the record and which is unreported. The findings of fact and conclusions of law of the District Court (R. 92–110) are unreported. The opinion of the Circuit Court of Appeals (R. 173–177) is reported in 154 F. 2d 968.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 10, 1946. (R. 177.) A

petition for rehearing was denied on May 15, 1946. (R. 181.) The petition for a writ of certiorari was filed on August 12, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Circuit Court of Appeals correctly affirmed the holding of the District Court that the taxpayer was not entitled to deductions in its 1933 and 1934 income and excess profits tax returns for a partially worthless debt under Section 23 (j), Revenue Act of 1932, and Section 23 (k), Revenue Act of 1934.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (j) *Bad Debts.*—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.
>
> * * * * *

The provisions of the above section are continued without substantial change in Section 23 (k) of the Revenue Act of 1934, c. 277, 48 Stat. 680.

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 191. *Bad debts.* * * *

* * * * *

Where all the surrounding and attending circumstances indicate that a debt is worthless, either wholly or in part, the amount which is worthless and charged off or written down to a nominal amount on the books of the taxpayer shall be allowed as a deduction in computing net income. There should accompany the return a statement showing the propriety of any deduction claimed for bad debts. No deduction shall be allowed for the part of a debt ascertained to be worthless and charged off prior to January 1, 1921, unless and until the debt is ascertained to be totally worthless and is finally charged off or is written down to a nominal amount, or the loss is determined in some manner by a closed and completed transaction. Before a taxpayer may charge off and deduct a debt in part, he must ascertain and be able to demonstrate, with a reasonable degree of certainty, the amount thereof which is uncollectible. Any amount subsequently received on account of a bad debt or on account of a part of such debt previously charged off and al-

> lowed as a deduction for income tax purposes, must be included in gross income for the taxable year in which received. In determining whether a debt is worthless in whole or in part the Commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor. Partial deductions will be allowed with respect to specific debts only.
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> * * * * *

Substantially the same provisions are contained in Article 23 (k)–1 of Treasury Regulations 86, promulgated under the Revenue Act of 1934.

STATEMENT

The facts as stipulated (R. 52–62) and as found by the District Court (R. 92–107) may be summarized as follows:

This is an action by Ensley Bank & Trust Company, hereinafter called the taxpayer, for the recovery of $4,587.65, plus interest, federal income and excess profits taxes for the years 1933 and 1934. (R. 92–93.)[1] During the years here involved, the taxpayer operated on the cash receipts and disbursements basis. (R. 54.)

The taxpayer was incorporated under the laws of Alabama as the Bank of Alabama in 1906, to engage in the general banking business in the En-

[1] The District Court entered judgment in favor of the taxpayer for $1,760.15 (R. 110), and the Government did not appeal.

sley District, Birmingham, Alabama. The banks in that district depended on the steel business and suffered seriously on account of the 1929 depression. As a result of the depression, the Bank of Alabama, in 1930, disposed of its assets and liabilities but continued its legal existence. (R. 93–94.)

In 1932, because of adverse conditions, it became apparent that the Ensley National Bank of Birmingham, Alabama, hereinafter called "National," could no longer conduct a banking business and it was decided to proceed with a voluntary liquidation of its affairs. On July 18, 1932, National by written contract, appointed the taxpayer as its liquidating agent or trustee, and on October 4, 1932, taxpayer's name was changed from Bank of Alabama to Ensley Bank & Trust Company. From and after July 19, 1932, and throughout 1933 and 1934, taxpayer was engaged in the general banking business in that part of Birmingham known as Ensley. (R. 93, 94.)

Under the original contract of July 18, 1932 (R. 34–44), later superseded by a contract dated February 1, 1933 (R. 13–33), taxpayer agreed to assume and pay off and discharge on demand all of National's debts, liabilities, commitments and obligations, with certain exceptions not material here. National agreed to pay taxpayer the amounts of the liability both thereby or thereafter assumed by taxpayer and in addition to pay

taxpayer at the latter's election as compensation for its services or as interest on the indebtedness assumed, certain specified amounts. Taxpayer was also to be reimbursed for its court costs, and other expenses of liquidation. National's obligation to taxpayer was to mature upon demand by the taxpayer after two years from the effective date of the contract, except that taxpayer could call on National for payment when that was deemed necessary in order that suits could be filed against National's stockholders within the period of the statute of limitations. (R. 94, 95, 96.)

All the assets, business and property of National, except its corporate franchise and its membership in the Federal Reserve system, were to be transferred to taxpayer for liquidation and as security for National's obligation to the taxpayer under the contract. Only cash transferred to taxpayer or realized out of the assets and property was to be considered as in payment or discharge of National's obligation. (R. 94, 96.)

The taxpayer was to proceed with the liquidation promptly, applying the net proceeds of collection upon National's indebtedness under the contract. It was provided that within 90 days after July 19, 1934, or within a period as extended by agreement of the parties, a final settlement in accounting would be made between the parties under which, if the charges to tax-

payer exceeded its credits, taxpayer was to transfer all remaining assets to National, while if the credits exceeded the charges, National was obligated to pay the difference. If the latter could not do so, all remaining assets might be foreclosed and sold. (R. 96–97.)

In accordance with the contract, taxpayer acquired all the assets and business of National including good will and proceeded to liquidate National. With this acquisition, it became the sole and dominating factor in the banking business in the Ensley locality. (R. 97.)

An examination of the affairs of National made by a vice-president of the First National Bank of Birmingham as of July 18, 1932, indicated that, without considering good will items, National was insolvent. At that time, $200,000 face value of stock of National was outstanding but the value of claims against the stockholders for double liability was not then appraised. (R. 97.) On July 18, 1932, and during the balance of that year, the responsible officers and officials of taxpayer knew, or should have known, that taxpayer would realize a loss on transactions covered by the contract between taxpayer and National insofar as all items of the contract were concerned with the exception of good will items. (R. 107.)

Pursuant to the contract, National gave taxpayer its note as of July 19, 1932, for $355,080.63 (R. 97.) During the year 1933 taxpayer realized

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from assets pledged to it by National the total sum of $87,271.16, and during the year 1934, the sum of $73,811.51. These sums were used to pay expenses, prior liens upon the assets, compensation to taxpayer, and to reduce National's obligation to taxpayer under the contract. (R. 103–105.) The last credit on National's note was made on June 1, 1933, reducing that note to $302,-229.44. Proceedings against stockholders of National were not started until July, 1934. In that year, $35,000 was collected and subsequent to that year, approximately $15,000 additional was collected. (R. 97–98.)

On August 12, 1934, taxpayer first made a demand on National for the balance of its principal claim as shown by accounting then made. National failed to make payment and taxpayer retained possession of the assets and continued to liquidate. (R. 106.)

On August 26, 1935, the taxpayer sold to the First National Bank of Birmingham, all of its assets, including good will, with certain exceptions not here material. First National assumed all of taxpayer's deposit liability not in excess of $611,336.87 and paid certain specified cash to taxpayer for retirement of its preferred stock. First National agreed that it would liquidate all of the transferred assets for the benefit of taxpayer's creditors and stockholders. (R. 98.)

In its income and excess profits tax returns for 1933 and 1934, the taxpayer took deductions in

the respective amounts of $13,039.03 and $14,318.03 of the amount due on the note of National on the theory of a debt ascertained to be partially worthless and charged off. These deductions were disallowed by the Commissioner resulting in that part of the deficiencies here in question. (R. 103, 104.) The deficiencies were paid with interest and the taxpayer filed timely claims for refund which the Commissioner rejected. Thereafter, the present suit was instituted to recover the alleged over-payment of tax.[2] (R. 99–102.)

The District Court held that the taxpayer was not entitled to the claimed deductions for a partially worthless debt (R. 108, 109) and the court below affirmed (R. 174–177).

ARGUMENT

Recovery was sought by the taxpayer in the present case on the ground that it was entitled to deductions in 1933 and 1934 for a debt ascertained to be partially worthless and charged off in each of those years in an amount not less than that deducted. The taxpayer does not question the correctness of the controlling principles of law stated by the court below with respect to that problem. The determination of the question whether taxpayer is entitled to the claimed deduc-

[2] The deficiencies asserted by the Commissioner, the claims for refund and the suit in the District Court also involved certain other items which are not presented in the petition for certiorari.

tions is one which turns upon the particular facts of this case, and no unsettled principle of law is involved.

We submit that the decisions of the District Court and of the court below, sustaining the Commissioner's denial of the claimed deductions, are correct under the facts of this case, and that there is no reason for this Court to review the question.

The taxpayer urges, however, as the reason why a writ of certiorari should be granted (Pet. 8–9) that the court below affirmed the judgment of the District Court on a ground which was not at issue in the District Court and that that court has thus so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of the power of supervision of this Court. The cases, such as *Helvering* v. *Wood,* 309 U. S. 344, relied upon by the taxpayer (Pet. 9) in this connection are all clearly distinguishable on their facts.

We submit that the pleadings and other proceedings in this case do not support the taxpayer's contention that the action of the court below was placed upon a ground raised by the court of its own motion and which was not at issue in this case. Moreover, there is nothing in the opinion of the court to indicate that it considered its decision as being placed upon a new ground, or to indicate that the court purported to exercise a power to affirm on facts which were

not at issue. Thus, the decision below presents no principle of importance to warrant review of this Court, nor has there been, under any view of the circumstances, such a failure of justice as to call for the exercise of the supervisory powers of this Court.

In respect to the partial bad debt deductions, the District Court concluded (R. 108–109) that the burden of proof was upon the taxpayer to establish that it was entitled to the deductions and to establish the amounts allowable and the proper year in which the deductions should be taken, and that the taxpayer had failed to carry that burden. The District Court further concluded (R. 109) that the allowance of the partial bad debt deductions was discretionary with the Commissioner of Internal Revenue, that this discretion was reviewable only when it had been abused and that it cannot be said that the Commissioner abused his discretion in disallowing the deductions in this case.

The court below, in its opinion, pointed out (R. 174) that the Commissioner ruled that the deductions claimed for the partially worthless debt were not allowable for the reason, among others, that there was no determination of worthlessness in 1933 and in 1934. The court further said (R. 174):

> But the appellee [the United States] contends both that there was no debt, and no ascertainment of partial worthlessness; and

> that any loss was one incurred in purchasing the good will and other assets of the Ensley National Bank. The district court appears to have held that the allowance of partial bad debt deductions *are* discretionary with the Commissioner, and that no abuse of discretion was shown, and that general losses in the transaction with Ensley National Bank were not realized till the transaction was finally closed out in 1935, a year not here involved.[3]

After discussing the applicable rule of law pertaining to the deduction of partially worthless debts and the facts of this case, the court below stated its conclusion that a case had not been made by the taxpayer that the Commissioner had arbitrarily refused the claimed partial bad debt deductions. This was the precise conclusion to

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[3] In its brief in the Circuit Court of Appeals, the Government contended in part as follows (pp. 19–20):

"We submit, however, that the Commissioner's action was clearly proper in disallowing the deductions for both 1933 and 1934. Under Section 23 (j), Revenue Act of 1932, and Section 23 (k), Revenue Act of 1934 * * *, the Commissioner *may*, if satisfied a debt is recoverable only in part, allow the same in an amount not in excess of the part charged off during the tax year. The Act gives the Commissioner a wide discretion and his actions in refusing the claimed partial debt deductions are not reviewable unless they are so arbitrary and unreasonable as to constitute an abuse of discretion. * * *.

"Here there was no abuse in the Commissioner's discretion because there was no showing that the debt was recoverable only in part. The evidence below does not establish that the debts were in fact uncollectible. * * *"

which the District Court had come. True, in reaching this conclusion, the court below emphasized the failure of the evidence to show clearly that in 1933 or 1934 the assets of National which secured its note held by taxpayer, plus the liabilities of National's stockholders upon their stock, would not eventually pay the note, but this, we submit, was a matter clearly within the scope of the issues in the case.

The burden was unquestionably upon the taxpayer to establish by appropriate allegation and proof that it had, in each of the years 1933 and 1934, ascertained the claimed amount of the debt to have become uncollectible in each of those years. We submit that there is no reasonable ground for the taxpayer's contention that the Government's answer in the District Court relieved the taxpayer of the burden of proving that it had ascertained in each of the taxable years the partial worthlessness of that part of the debt sought to be deducted.

In paragraph 5 of the complaint, the taxpayer alleged (R. 3–4) that at the time it assumed the Ensley National Bank's liabilities, though it considered some loss probable, it expected to recover from the assets pledged and from the stockholders a substantial amount of its claim against the Ensley National Bank and that it did not consider impossible a recovery of the entire amount thereof, but subsequent experience demonstrated that

the Ensley National Bank was hopelessly insolvent at the time of the take-over and that the taxpayer, before the end of 1932, had discovered that a substantial loss on its claim was inevitable. In its original answer filed February 22, 1941 (R. 44, 45), the Government did not deny this allegation. However, in an amendment to the answer filed on June 17, 1944 (R. 50–51) the Government alleged that it did not have sufficient knowledge or information upon which to form a belief as to the truth of these allegations in paragraph 5 of the complaint, and that these allegations were therefore denied.

While paragraph 6 of the Government's answer (R. 46) alleges that any loss taxpayer expected to sustain from the liquidation of the assets of the Ensley National Bank pledged to it was ascertained prior to the year 1933, and while this portion of the answer was not altered in the amendment to the answer filed in 1944, the taxpayer could not, we believe, have been misled by that allegation in view of the Government's denial by its amended answer of the similar allegation which the taxpayer itself had made in the complaint. Moreover, in paragraph 6 of the answer, the Government denied taxpayer's allegation that it had, before the end of 1933, determined the maximum recovery to be expected from the assets of the Ensley National Bank and specifically averred (R. 46) that taxpayer was not entitled,

under the facts and the law, to a deduction of $13,039.03 from gross income as a debt ascertained to be worthless, and charged off in the year 1933.

With respect to the year 1934, paragraph 7 of the answer (R. 47) specifically denies that the taxpayer ascertained to be worthless in the year 1934 the $64,138.03 which taxpayer alleged it charged off as a worthless debt owing to it by the Ensley National Bank.

The order on pretrial hearing entered by the District Court (R. 48–49) also states as an issue in this case to which the Government pleaded the general issue, the question whether the taxpayer was entitled to deduct from gross income certain bad debts for 1933 and 1934 as "ascertainment of these amounts as partial loss in the debt of Ensley National Bank" to the taxpayer.

The manner in which the witnesses were examined further negatives any contention that the question of the ascertainment of what recovery might be had from National's stockholders was not within the issues made by the pleadings. Thus, taxpayer's counsel asked the first witness for the taxpayer the question (R. 117):

> Would you say it was reasonably establishable at the end of 1933 and at the end of 1934 that the indebtedness of Ensley National Bank to Ensley Bank & Trust Company [taxpayer] could not be collected in full?

The answer to this question was "yes." Upon cross-examination the witness stated (R. 121) that the book value of the assets transferred to the taxpayer in 1932, and which secured the note of $355,080.63 here in question, was approximately $971,000 at the time of the transfer, and when asked if he had appraised the value of the claims against National's stockholders or the possibility of collecting from them, the witness stated that he had not at that time.

The next witness for taxpayer was also asked by taxpayer's counsel (R. 132) whether, in his opinion, the indebtedness of National to taxpayer was collectible in full, and the witness answered that in his opinion it was not collectible in full. Upon cross-examination (R. 137), this witness testified that he knew there would be a loss on the assets of National, but that whether it would finally result in a loss to taxpayer was a question of the stockholders' liability, and that he had not gone into the details of the proposition, taking it as a whole. The witness further testified (R. 138) that the condition of the assets continued to change in 1933 and 1934 for the worse, but that in 1935 some of the assets improved and some got worse.

CONCLUSION

The decision below is correct. The case is one turning upon its own particular facts, and no important unsettled principle is involved, nor is

there a conflict of decisions. The case does not call for further review.

Respectfully submitted.

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